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BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

Arizona Corporation Commission

DOCKETED

MAR 17 2010

KRISTIN K. MAYES - Chairman
GARY PIERCE
PAUL NEWMAN
SANDRA D. KENNEDY
BOB STUMP

DOCKETED BY

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IN THE MATTER OF THE APPLICATION OF
FARMERS WATER CO., AN ARIZONA
CORPORATION, FOR A DETERMINATION OF
THE CURRENT FAIR VALUE OF ITS UTILITY
PLANT AND PROPERTY AND FOR
INCREASES IN ITS RATES AND CHARGES
FOR UTILITY SERVICE.

DOCKET NO. W-01654A-08-0502

DECISION NO. 71510

OPINION AND ORDER

DATE OF HEARING: November 4, 2009
PLACE OF HEARING: Tucson, Arizona
ADMINISTRATIVE LAW JUDGE: Jane L. Rodda
APPEARANCES: Mr. Robert Metli, SNELL & WILMER, on behalf of
Farmers Water Co.; and
Ms. Ayesha Vohra and Mr. Wesley Van Cleve, Staff
Attorneys, Legal Division, on behalf of the Utilities
Division of the Arizona Corporation Commission.

BY THE COMMISSION:

* * * * *

Having considered the entire record herein and being fully advised in the premises, the
Arizona Corporation Commission ("Commission") finds, concludes, and orders that:

FINDINGS OF FACT

Background

1. On September 29, 2008, Farmers Water Co. ("Farmers" or "Company") filed an application for a rate increase with the Commission.
2. On October 29, 2008, and December 11, 2008, the Commission's Utilities Division ("Staff") notified the Company that its application was not sufficient under the requirements of the Arizona Administrative Code.

1 3. The Company filed additional information on November 12, 2008, and January 6,
2 2009.

3 4. On February 6, 2009, Staff notified the Company that its rate application was
4 sufficient, and classified the Company as a Class C utility.

5 5. By Procedural Order dated February 17, 2009, procedural guidelines were established
6 and the matter was set for hearing on September 2, 2009.

7 6. On March 24, 2009, Farmers mailed notice of the hearing to its customers.

8 7. On June 9, 2009, Staff requested an extension of 60 days to file its Staff Report
9 because of personnel changes. Farmers did not object and the parties agreed to a revised schedule.

10 8. By Procedural Order dated June 20, 2009, the hearing was rescheduled for November
11 4, 2009.

12 9. On June 29, 2009, Farmers filed an Affidavit of Public Notice indicating that it mailed
13 the notice of the revised hearing date to its customers on June 22, 2009.

14 10. On August 21, 2009, Staff filed the Direct Testimony of Charles Mylhousen and Jian
15 Liu.

16 11. On September 25, 2009, Farmers filed the Rebuttal Testimony of Thomas Bourassa
17 and Heather Triana.

18 12. On September 30, 2009, Farmers filed the Corrected Rebuttal Testimonies of Mr.
19 Bourassa and Ms. Triana.

20 13. On October 14, 2009, Staff filed the Surrebuttal Testimony of Mr. Mylhousen and Mr.
21 Liu.

22 14. On October 27, 2009, Farmers filed the Rejoinder Testimony of Mr. Bourassa.

23 15. The hearing convened as scheduled, before a duly authorized Administrative Law
24 Judge, on November 4, 2009.

25 16. On December 11, 2009, Farmers and Staff filed Closing Briefs.

26 17. Farmers is an Arizona Sub-Chapter "S" Corporation that provides water utility service
27 to approximately 2,240 customers in portions of Pima County near the Town of Sahuarita.

28 18. Farmers is wholly owned by Farmers Investment Company ("FICO"). FICO is a Sub-

Chapter "S" corporation, with 35 shareholders. FICO also has other divisions engaged in business endeavors separate from water utility service.

19. Farmers' current rates were approved in Decision No. 63749 (June 6, 2001). Since the prior rate case, the Company has grown from approximately 912 service connections to 2,240 connections.

20. In Decision No. 68920 (August 29, 2006), the Company was granted an extension of its Certificate of Convenience and Necessity and was ordered to file a rate case by June 30, 2008, using a 2007 test year. In Decision No. 70473 (September 2, 2008), the Commission granted Farmers a ninety day extension to file its rate case.

21. The Company is located in the Tucson Active Management Area.

22. The Company provides service through four water systems: the Sahuarita, Continental, Santa Rita Springs and Sahuarita Highlands systems.

23. In the test year ended September 30, 2007, Farmers had total operating revenues of \$563,283. The Company reported adjusted test year operating expenses of \$629,806, resulting in an operating loss of \$66,523.¹ Staff recommended adjusted test year operating expenses of \$650,975, which produced an operating loss of \$87,692.²

24. The Company is seeking total operating revenues of \$759,404, an increase of \$196,121, or 34.82 percent, over test year revenues. The Company's proposed operating expenses of \$683,464 would yield operating income of \$75,940, and result in a 10 percent operating margin.³ The Company believes the 10 percent operating margin would provide sufficient revenues to fund on-going operating expenses, expected capital repairs and improvements and maintain the Company's financial stability. The Company also believes that a 10 percent operating margin is at the very minimum, and is at the low end of the range that Staff typically recommends for situations when an operating margin approach to determining the revenue requirement is employed (typically between 10 and 20 percent according to the Company). In this case, the Company states, utilizing the rate of return on rate base is not a meaningful method to determine the revenue requirement because

¹ Ex A-2 Bourassa Rebuttal at C-1.

² Ex S-4 Mylhausen Surrebuttal at CRM-4.

³ Ex A-2 at C-1

the Company has a negative rate base.

25. Staff recommends rates that would produce total revenues of \$726,887,⁴ an increase over test year revenues of \$163,604, or 29.04% percent. After adjusted operating expenses of \$654,198, Staff's rates would yield operating income of \$72,689.⁵ Staff concurred that using a 10 percent operating margin is appropriate for this Company. Staff's recommended rates that differ from the Company's proposal due to the parties' differences concerning allowed operating expenses.

26. Farmers' current rates and charges and those proposed by the Company and Staff are set forth below:

	Present Rates	Company Proposed	Staff Recommended
<u>MONTHLY USAGE CHARGE:</u>			
5/8" x 3/4" Meter (All Classes)	\$ 6.50	\$ 8.26	\$ 8.25
3/4" Meter (All Classes)	6.50	8.26	9.28
1" Meter (All Classes)	9.00	10.32	10.32
1-1/2" Meter (All Classes)	13.00	20.64	20.64
2" Meter (All Classes)	19.50	33.02	33.02
3" Meter (All Classes)	25.00	66.04	66.04
4" Meter (All Classes)	32.00	103.19	103.19
6" Meter (All Classes)	40.00	206.38	206.38
2" Standpipe	19.50	33.02	0
6" Standpipe	40.00	206.38	0
<u>COMMODITY CHARGES</u>			
Per 1,000 Gallons			
<u>5/8-Inch Meter- Residential</u>			
1 to 5,000 Gallons	\$1.25	0	0
5,001 to 10,000 Gallons	1.45	0	0
Over 10,000 Gallons	1.65	0	0
1 to 4,000 Gallons	0	\$1.45	\$1.35
4,001 to 10,000 Gallons	0	1.92	1.90
Over 10,000 Gallons	0	2.49	2.45
<u>5/8-Inch Meter -Commercial and Industrial</u>			
1 to 10,000 Gallons	0	1.90	1.90
Over 10,000 Gallons	0	2.49	2.45
<u>3/4-Inch Meter Residential</u>			
1 to 4,000 Gallons	N/A	N/A	1.35
4,001 to 10,000 Gallons	N/A	N/A	1.90
Over 10,000 Gallons	N/A	N/A	2.45
<u>1-Inch Meter (All Classes)</u>			
0 to 5,000 Gallons	1.25	0	0

⁴ Ex S-4 at CRM-4.

⁵ *Id.*

1	5,000 to 10,000 Gallons	1.45	0	0
	Over 10,000 Gallons	1.65	0	0
2	1 to 12,500 Gallons	N/A	1.90	1.90
	Over 12,500 Gallons	N/A	2.49	2.45
3	<u>2-Inch Meter (All Classes)</u>			
	0 – 5,000 Gallons	1.25	0	0
4	5,000 – 10,000 Gallons	1.45	0	0
	Over 10,000 Gallons	1.65	0	0
5	1 – 40,000 Gallons	0	1.90	1.90
6	Over 40,000 Gallons	0	2.49	2.45
	<u>3-Inch Meter (All Classes)</u>			
7	0 – 5,000 Gallons	1.25	0	0
	5,000 – 10,000 Gallons	1.45	0	0
8	Over 10,000 Gallons	1.65	0	0
9	1 – 80,000 Gallons	0	1.90	1.90
	Over 80,000 Gallons	0	2.49	2.45
10	<u>4-Inch Meter (All Classes)</u>			
	0 – 5,000 Gallons	1.25	0	0
11	5,000 – 10,000 Gallons	1.45	0	0
	Over 10,000 Gallons	1.65	0	0
12	1 – 126,000 Gallons	0	1.90	1.90
13	Over 126,000 Gallons	0	2.49	2.45
	<u>6-Inch Meter (All Classes)</u>			
14	0 – 5,000 Gallons	1.25	0	0
	5,000 – 10,000 Gallons	1.45	0	0
15	Over 10,000 Gallons	1.65	0	0
16	1 – 250,000 Gallons	0	1.90	1.90
	Over 250,000 Gallons	0	2.49	2.45
17	<u>2-Inch Standpipe – Per 1,000 Gallons</u>	1.25	2.49	2.45
	<u>6-Inch Standpipe – Per 1,000 Gallons</u>	1.25	2.49	2.45

	<u>Present</u>	<u>Company Proposed</u>			<u>Staff Recommended</u>		
	Total	Service Line	Meter Installation	Total	Service Line	Meter Installation	Total
19							
20	5/8" x 3/4" Meter \$ 520.00	\$ 385.00	\$ 135.00	\$ 520.00	\$ 385.00	\$ 135.00	\$ 520.00
	3/4" Meter 600.00	415.00	205.00	620.00	415.00	205.00	620.00
	1" Meter 690.00	465.00	265.00	730.00	465.00	265.00	730.00
21	1-1/2" Meter 935.00	520.00	475.00	995.00	520.00	475.00	995.00
	2" Turbine Meter 1,596.00	800.00	995.00	1,795.00	800.00	995.00	1,795.00
	2" Compound Meter 2,320.00	800.00	1,840.00	2,640.00	800.00	1,840.00	2,640.00
22	3" Turbine Meter 2,275.00	1,015.00	1,620.00	2,835.00	1,015.00	1,620.00	2,635.00
	3" Compound Meter 3,110.00	1,135.00	2,495.00	3,830.00	1,135.00	2,495.00	3,630.00
23	4" Turbine Meter 3,520.00	1,430.00	2,570.00	4,000.00	1,430.00	2,570.00	4,000.00
	4" Compound Meter 4,750.00	1,610.00	3,545.00	5,155.00	1,610.00	3,545.00	5,155.00
	6" Turbine Meter 6,275.00	2,150.00	4,925.00	7,075.00	2,150.00	4,925.00	7,075.00
24	6" Compound Meter 8,050.00	2,270.00	6,820.00	9,090.00	2,270.00	6,820.00	9,090.00
	8" Meter At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost
25	10" At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost
	12" At Cost	At Cost	At Cost	At Cost	At Cost	At Cost	At Cost

Note: Meter charge includes meter box or vault.

	<u>Present</u>	<u>Company</u>	<u>Staff</u>
	<u>Rates</u>	<u>Proposed</u>	<u>Recommended</u>
27	<u>SERVICE CHARGES:</u>		
	Establishment \$25.00	\$35.00	\$35.00
28	Establishment (After Hours) 25.00	50.00	50.00

1	Reconnection (Delinquent)	25.00	40.00	40.00
2	Reconnection (Delinquent – After hours)	N/T	55.00	55.00
3	Meter Test (If Correct)	\$25.00	25.00	25.00
4	Hydrant Meter Deposit (Refundable)	N/T	150.00	150.00
5	Deposit	*	*	*
6	Deposit Interest	*	*	6%
7	Re-Establishment (Within 12 months)	**	**	**
8	NSF Check	\$20.00	\$20.00	\$20.00
9	Deferred Payment Per Month	N/T	1.50%	1.50%
10	Meter Re-Read (If Correct)	20.00	20.00	20.00
11	After hours service charge – Per Rule R14-2-403D	N/T	Cost	Cost
12	Late Charge per month	N/T	1.50%	1.50%
13	Meter Tampering Charge	N/T	Cost	Cost
14	Meter Box “Cut Lock” Charge	N/T	Cost	Cost
15	Meter Box Re-Inspection	N/T	\$50.00	***

Company's Proposed

* Per Commission Rules (R14-2-403B)

** Months off systems times the minimum. Per Commission Rule (R14-2-403D)

N/T No Tariff

In addition to the collection regular rates, the utility will collect from its customers a proportionate share of any privilege, sales use and franchise tax. Per Commission Rule (14-2-409.D5)

Staff's Recommended

* Per rule R14-2-403.B

** Months of system times the minimum (R14-2-403.D)

Late Charge 1.50 percent of the unpaid balance per month

*** Per Rule R14-2-407.B⁶

In addition to the collection regular rates, the utility will collect from its customers a proportionate share of any privilege, sales use and franchise tax. Per Commission Rule (14-2-409.D5)

27. The Company and Staff agreed on most rate making issues in this case, but disagreed about: 1) whether income tax expenses should be excluded from the Company's revenue requirement; 2) the interest rate to be paid on customer deposits; and 3) the rate design for standpipe customers. In addition, the Company argued for an alternative method for collecting rate case expense.

Rate Base

28. Staff and the Company determined that at the end of the test year, the Company had an

⁶ During the hearing, Staff and the Company clarified that Staff interprets Rule 14-2-407.B, to include the cost of re-inspecting a damaged meter. With this understanding the Company does not disagree with Staff's recommendation. See Transcript of November 4, 2009, Hearing ("Tr.") at 44 and 95.

1 adjusted rate base of negative \$748,646. The Company had plant-in-service of \$6,591,381, with Net
2 Contributions in Aid of Construction ("CIAC") of \$465,111 and Advances in Aid of Construction
3 ("AIAC") of \$6,874,915.

4 29. The evidence supports an original cost rate base ("OCRB") of negative \$748,646. The
5 Company has requested its OCRB be used as its fair value rate base ("FVRB").⁷

6 Operating Revenue and Expenses

7 30. Throughout the course of the proceeding the parties reviewed and revised their
8 positions concerning operating expenses with the result that at the time of the hearing, the only
9 expenses in dispute were interest expenses on customer deposits, and the income tax expense. In
10 addition, the Company recommends using a surcharge mechanism as an alternative method of
11 collecting rate case expense.⁸

12 31. The parties employ the same depreciation rates.⁹

13 Customer Deposit Interest Expense

14 32. The Company requested that that the Commission adopt a 2 percent interest rate on
15 customer deposits.

16 33. Staff recommended that the Company be ordered to pay interest on customer deposits
17 at 6 percent annually, which Staff states is the standard interest that Staff recommends, and the
18 Commission has approved, for other water companies. Staff makes the recommendation because
19 interest rates fluctuate, and although current interest rates are low, and closer to 2 percent, in the
20 recent past, interest rates have been much higher. Staff asserts that the Company has the ability to
21 seek recovery of customer deposit interest expense in a future rate case.¹⁰ Staff asserts that if the
22 Commission adopts the Company's recommended 2 percent interest rate, the Company could be
23 paying interest on deposits at a rate lower than market rates until the next rate. Staff recommends that
24 the Commission continue to order a 6 percent customer deposit interest rate as a reasonable average
25 of a historically fluctuating deposit interest rate.¹¹

26 ⁷ Ex A-1 Bourassa Direct at 7.

27 ⁸ Farmers Brief at 4.

⁹ Ex A-2 Bourassa Corrected Rebuttal at 4.

¹⁰ Tr. at 68.

28 ¹¹ Staff's Brief at 5.

34. The Company believes a 6 percent rate is too high given the low interest rates currently provided by banks on certificates of deposits ("CDs") and money markets. The Company submits that the annual yield on a 5-year CD is 2.66 percent (Wall Street Journal, September 3, 2009); 0.36 percent on a 6-month CD (Federal Reserve, September 1, 2009); and 1.16 percent on the money market (Wall Street Journal, September 3, 2009).¹² In any event, the Company states it did not include customer deposits as an operating expense in the income statement in its rate application.¹³

35. The Company testified that it does not collect customer deposits and that this practice has not been detrimental.¹⁴ Therefore, the issue of the interest rate to be applied to customer deposits does not affect the revenue requirement in this case. Recent Commission practice has been to use an interest rate of 6 percent annually on customer deposits. Interest rates will fluctuate over time, and thus there will always be an issue that a fixed rate paid on customer deposits is too low or too high. Absent evidence that the current Commission practice is contrary to the public interest, we approve Staff's recommended 6 percent rate. If the Company requires customer deposits in the future, it can include the security deposit interest paid as an operating expense.

Income Tax Expense

36. Since the last rate case, Farmers was converted from a Sub-Chapter "C" corporation to a Sub-Chapter "S" corporation. A Sub-Chapter "S" corporation ("S-Corp") does not pay income taxes, but rather the income of the corporation flows through to the shareholders who are responsible for the income taxes at the shareholders' tax rate. The Company witness testified that when FICO, Farmers' parent, converted to an S-Corp, Farmers was also required to become an S-Corp.¹⁵ Although, normally, as an S-Corp, FICO would not pay income taxes, Ms. Triana testified that for a period after the conversion to S-Corp status, it must continue to file returns.¹⁶ Consequently, at this time, FICO and Farmers file a consolidated tax return.¹⁷

¹² Ex A-3 Triana Corrected Rebuttal at 14.

¹³ Tr. at 17.

¹⁴ Tr. at 74.

¹⁵ Tr. at 64.

¹⁶ Tr. at 70.

¹⁷ Tr. at 66.

1 37. FICO and its shareholders entered into a "Shareholder Agreement" effective
2 September 30, 2005, which contains a "Dividend Policy" as follows:

3 Unless prohibited by law, the Company shall declare and pay dividends
4 with respect to each of its fiscal years in an amount at least equal to the
5 sum of (a) a percentage of its earnings and profits (as determined for
6 federal income tax purposes) that is the same as the highest federal and
7 Arizona income tax rate on ordinary income for individuals and (b) a
8 percentage of its net long-term capital gains and net gains from the sale or
exchange of assets, the gain from which are taxable under Code Section
1231, which is the same as the highest federal and Arizona income tax rate
on such gains for individuals. Such dividends shall be declared and paid
before April 1 of the following year.

9 38. Staff recommends excluding income tax expense from the determination of Farmers'
10 revenue requirement because Farmers does not pay taxes on a corporate level. Staff states that as
11 recognized in Decision No. 71445 (December 23, 2009), the recent Sunrise Water Co. rate case,
12 "[t]he Commission has established a long-standing policy of denying recovery of income tax
13 expenses for pass-thru entities and apparently has varied from it, at least in recent years, only as an
14 exception made under unique circumstances or as an inadvertent error."¹⁸ Further, Staff argues, the
15 Arizona Court of Appeals has held that the Commission has the authority to disallow income tax
16 expense in revenue requirement determinations.¹⁹ Staff states the Commission has consistently
17 disallowed income tax expense from revenue requirement in cases involving S-Corps and Limited
18 Liability Companies.²⁰

19 39. Farmers argues that the income tax liability arises from the taxable income of the
20 utility and is directly attributable to Farmers, and that while Farmers does not pay the income taxes, it
21 does reimburse the shareholders for the taxes that must be paid as a result of Farmers' activities.
22 Farmers states that the Company and its shareholders have an agreement that provides that the
23 Company will pay a dividend to its shareholder each year for the federal and Arizona income tax
24 rates for ordinary income that is produced by the Company.

25 ¹⁸ Decision No. 71445 at 36.

26 ¹⁹ *Consolidated Water Utilities, Ltd. v. Ariz. Corp. Comm'n*, 178 Ariz. 478, 484 (Ariz. App. Div 1, 1993).

27 ²⁰ *Citing* Fishers Landing Water and Sewer Works LLC (Docket No. WS-04047A-07-0700 and WS-04047A-07-
28 0708)(disallowing recovery of income tax expense); Winchester Water Company LLC (Docket No. W-04081A-07-
0466)(disallowing recovery of income tax expense); and also Decision No. 60105 (S-Corporation allowed to recover
income tax expense because Company was unable to obtain bank loan unless Commission approved rates that allowed for
income taxes).

1 40. Staff argues that the Shareholder Agreement is between FICO and its shareholder, and
2 although it addresses the payment of dividends for taxes, neither Farmers, nor its ratepayers are
3 parties to the agreement. Staff states the end result is that Farmers is asking its ratepayers to pay the
4 income tax liability on non-regulated, non-utility income of FICO.²¹

5 41. Finally, Staff argues that the election to become an S-Corp was voluntary, and FICO
6 and Farmers have the ability to revert to a C-Corp.²²

7 42. Farmers argued that there is no sound justification to treat the S-Corp differently than
8 a C-Corp. The Company asserts that under Staff's proposal, an S-Corp would receive a lower
9 revenue requirement and operating income than an otherwise identical C-Corp which would be
10 inequitable because the money for the taxes must come from somewhere. Ultimately, Farmers states,
11 the money to pay the taxes comes from the S-Corp because shareholders insure their taxes are paid by
12 the entities that generate them.

13 43. In addition, Farmers argues the ratepayers would receive an unjustified windfall from
14 the lower revenue requirement and operating income when income taxes are excluded. Farmers
15 argues rate making should be applied in a manner that produces reasonable, realistic and non-
16 discriminatory results no matter what the legal form of the utility, and the inclusion or exclusion of
17 income taxes should not be limited to technical distinctions. Farmers argues the income taxes the
18 shareholders are required to pay are inescapable business outlays that are directly attributed to the
19 utility.

20 44. Farmers does not dispute that the Commission has the authority to allow the recovery
21 of income tax expense on a case by case basis. The Company admits that other state commissions
22 vary as to whether income taxes for pass-through entities are allowed in cost of service.²³

23 45. Farmers argues that the best rationale for the allowance of income tax expense for
24 pass-through entities was set forth in *ExxonMobil Oil Corp. v Federal Energy Regulatory Comm'n*,
25 487 F.3d 945, 376 U.S. App. D.C. 259 (D.C. Cir. 2007). In the *ExxonMobil* case, FERC determined
26 that income taxes paid by partners on their distributive share of the pipeline's income are "just as

27 ²¹ Staff Brief at 4.

28 ²² Staff Brief at 4.

²³ See Farmers' Brief at 8.

1 much a cost of acquiring and operating the assets of that entity as if the utility assets were owned by a
2 corporation.” In that case, FERC determined that there was no good reason to limit the income tax
3 allowance to corporations and that the income taxes paid on the partners’ distributive share of the
4 pipeline’s income were properly attributable to the regulated entity because the taxes had to be paid
5 regardless of whether the partners actually receive a cash distribution.

6 46. Farmers argues that because the requested 10 percent operating margin is at the very
7 minimum of what it should be, to exclude the income tax expense would cause the operating margin
8 to fall below that amount because the Company will reimburse shareholders for the tax liability.
9 Farmers asserts that to exclude the income tax expense will cause the Company’s cash flow to fall
10 below \$50,000.²⁴

11 47. This Commission has recently addressed the issue of the allowance of income tax
12 expense for a pass-through entity in the Sunrise Water Co. rate case (Decision No. 71445). In that
13 docket, the Commission determined not to allow the recovery of hypothetical income tax expense
14 based on long-standing Commission policy and because there was no evidence that the utility
15 actually passed income to the shareholder or that the shareholder paid taxes thereon, and because the
16 utility could easily become a C-Corp.²⁵ We will not deviate from Commission practice with respect
17 to the allowance of income tax expense in this case. Farmers’ shareholders made a calculated
18 decision to convert Farmers to an S-Corp and have not presented evidence the conversion benefits
19 ratepayers. The Commission’s policy of not allowing income tax expense for pass-through S-Corps
20 or LLCs was in effect at the time of the conversion. The Company’s claim that its cash flow would
21 be less than \$50,000 under Staff’s recommendations would be true only if the Company actually
22 advances the dividends. Staff’s recommended revenue requirement provides an estimated annual cash
23 flow of \$234,104 (determined by subtracting depreciation expense from operating income) which
24 appears to be sufficient for this Company. In this case, the Company has failed to demonstrate the
25 equity of up-streaming dividends for the maximum amount of the hypothetical tax liability or that the
26 cash flow from Staff’s recommended operating income is inadequate. In addition, Farmers has failed

27
28 ²⁴ Tr. at 34.

²⁵ Decision No. 71445 at 37.

1 to demonstrate the equity of approving additional revenue to allow Farmers to advance funds to its
2 parent, and ultimately its parent's shareholders, for hypothetical taxes, when this Company's parent
3 has decided not to invest its own capital to fund plant, resulting in a negative Fair Value Rate Base.
4 Mr. Bourassa testified that the Company has refunds on its AIAC of "several hundred thousand
5 dollars a year,"²⁶ but the Company did not prepare a cash flow analysis or present other reliable
6 evidence that Staff's recommended revenue results in inadequate cash flow. Farmers' shareholders
7 will have to determine if the Company's finances can support the payment of dividends for taxes as
8 well as the refunds on AIAC. While AIAC can be a low cost form of capital for new plant, its
9 associated refund obligations can place a burden on a utility's cash flow. The Commission will direct
10 Farmers to evaluate how it can move to a more balanced capital structure.

11 Rate Case Expense

12 48. Staff and the Company agree that the annual amount of the rate case expense should
13 be \$15,000. Staff reached its recommended expense by "normalizing" the rate case expense over five
14 years. The Company argues that using a five year normalization period penalizes the Company if the
15 Company files for rates sooner than five years, as the amount of the expense not collected is forfeited.
16 The Company proposed that rate case expense should not be recovered through rates, but rather
17 collected by means of a rate case expense surcharge. As such, Farmers asserts, it would be treated
18 like other regulatory assets, and the expense would be recovered in full, and neither over, nor under-
19 collected.²⁷

20 49. The Company raised its rate case expense surcharge proposal in its rebuttal
21 testimony.²⁸ Staff testimony did not address the proposal, and the parties did not discuss the issue at
22 the hearing. There is no dispute that in this case an annual rate case expense of \$15,000 is reasonable
23 and appropriate. The Company controls the timing of its rate cases, and has not shown why this
24 expense should be treated any differently than other operating expenses. Consequently, we decline to
25 adopt the surcharge proposal in this proceeding and will continue to utilize Staff's proposed
26 normalization technique for determining allowable rate case expense.

27 ²⁶ Tr. at 32.

28 ²⁷ Farmers Brief at 4-5.

²⁸ Ex A-2 at 8.

1 Revenue Requirement

2 50. Based on the foregoing, we adopt Staff's recommended revenue requirement of
3 \$726,887, which after adjusted operating expenses of \$654,198, results in operating income of
4 \$72,689.

5 Rate Design

6 51. The Company currently has a three-tiered inverted rate design, with three tiers for the
7 residential meter sizes and two tiers for the larger meter sizes. The only issue at dispute in this case
8 with respect to rate design is whether a monthly customer charge should apply to the
9 standpipe/construction/bulk water meters.²⁹ The Company currently has 2 inch and 6 inch
10 construction or standpipe meter customers and is authorized to charge these customers the same
11 monthly charge as it charges for the comparable size permanent meters.

12 52. Staff recommends no monthly minimum for the construction and standpipe meters and
13 a commodity rate of \$2.45 per \$1,000 gallons for these customers (the highest tier commodity rate).³⁰

14 53. In response to the Company's suggestion that having a monthly charge associated with
15 the construction and standpipe meters would add incentive to customers to return the meters when not
16 being used, Staff asserts that a monthly minimum charge is normally associated with permanent
17 customers and is designed to recover the fixed costs related to providing service. According to Staff,
18 any fixed costs that may be associated with providing standpipe service would be recovered by the
19 Company by applying the highest commodity rate.³¹ Staff states that if the Commission were to
20 authorize the Company to charge a monthly minimum charge for standpipe customers, Staff would
21 not recommend the application of the higher commodity charge.

22 54. Staff suggests that the fact that the Company is not currently requiring construction
23 and standpipe water users to pay a deposit for their meters indicates that Farmers is not encountering
24 problems from delays in returning meters.³² Staff states further that if the Company has problems in
25

26 ²⁹ In their testimony and schedules, neither Staff nor the Company distinguish between a standpipe or construction meter.
Typically, construction meters are assigned to a particular customer while standpipes are available to use by a numerous
27 entities.

28 ³⁰ Ex S-4 at 4 and Tr. at 111.

³¹ Ex S-4 at 4.

³² Tr. at 74.

1 the future with customers not returning meters, the Company can begin charging its authorized
2 deposit for construction and standpipe water meters.

3 55. The Company testified that the purpose of the monthly charge for construction and
4 standpipe meters is to cover fixed costs but also to send a signal to developers to return the meters.³³
5 The Company testified that a standpipe customer might not care about the return of their deposit and
6 keep the meter even if not being used, and if there was no usage in a particular month, there would be
7 no charge, even though the Company incurs the expense of reading the meter as well as other
8 administrative costs.³⁴

9 56. The Company has a valid point that it would not recover any of its costs of reading the
10 construction and standpipe meters if there is no usage for a given month. These meters place a
11 demand on the system and there are costs associated with meter reading and billing; there appears to
12 be no reason not to treat these meters on par with permanent meters of the same size. This Company
13 currently has an authorized monthly charge for standpipe and construction meters, and these
14 customers are used to incurring the charge. Staff has not convinced us that it is beneficial to alter the
15 existing rate structure. For the foregoing reasons, we approve a monthly charge for any individually
16 assigned standpipe or construction meter at Staff's proposed monthly rate for comparable size meters.
17 However, to allow the application of the highest tier rate to all usage for these meters in addition to a
18 monthly customer charge would charge these customers more than the comparable class of
19 permanent meter without evidence to support the reasonableness of such outcome. Thus, in this case,
20 it is reasonable to apply Staff's recommended tier rates to construction and standpipe usage where
21 there is a customer assigned to the meter. If the Company has a standpipe without an assigned
22 customer, there is no customer to assign a monthly charge, and so, it is logical to charge the highest
23 commodity rate for all usage to cover the fixed costs of administering these meters.

24 57. We note that the 6 inch standpipe meter, which will experience the greatest impact
25 from the Company's proposal, is associated with FICO, Farmers' parent company. In the test year,
26 the Company had an average of eight 2 inch and one 6 inch standpipe customers, and the revenue
27

28 ³³ Tr. at 55.

³⁴ Tr. at 49.

1 impact of the standpipe customer class is relatively insignificant.

2 58. Under the Company's proposed rates, the average 5/8 inch residential customer, using
3 5,898 gallons, would see a monthly increase of \$3.65, or 25.99 percent, from \$14.05 to \$17.70.

4 59. Under Staff's proposed rates, the average residential customer, using 5,898 gallons,
5 would see a monthly increase of \$3.20, or 22.8 percent, from \$14.05 to \$17.26.

6 60. Based on our approved revenue requirement, we adopt Staff's proposed rates, except
7 for the modification to the standpipe and construction meter rates discussed above.

8 Other Findings and Recommendations

9 61. Because this Company has a negative rate base, the Commission is unable to set rates
10 based on fair value. In order to reach a more balanced capital structure, we direct the Company to
11 develop and file with the Commission an equity improvement plan by March 31, 2011.

12 62. Staff received a compliance report from the Arizona Department of Water Resources
13 ("ADWR") in November 2008. According to Staff, ADWR reported that Farmers is in compliance
14 with requirements governing water providers and/or community water systems.

15 63. Staff testified that the Arizona Department of Environmental Quality ("ADEQ")
16 reported that Farmers drinking water systems are in compliance with regulatory agency requirements
17 and are currently delivering water that meets State and Federal drinking water quality standards as
18 required by the Arizona Administrative Code, Title 18, Chapter 4.

19 64. The Commission's Utility Division Compliance Section showed no delinquent
20 compliance items.

21 65. Staff reports that Farmers has a curtailment plan filed with the Commission.

22 66. Staff states Farmers' existing systems have adequate well production and storage
23 capacity.

24 67. Staff states that non-account water should be 10 percent or less and never more than
25 15 percent. Staff reported that the Continental water system reported a water loss of 10.07 percent,
26 and the Sahuarita Highlands system reported water loss of 13.3 percent for the test year 2007.

27 68. Staff recommends that the Company evaluate its water systems and prepare a report
28 for corrective measures demonstrating how the Company will reduce its water loss to less than 10

1 percent. If the Company finds that it cannot cost-effectively reduce its water loss to less than 10
 2 percent by December 31, 2010, it should submit a detailed cost analysis and explanation
 3 demonstrating why water loss reduction to less than 10 percent is not cost effective. Staff states the
 4 Company should file such report with Docket Control as a compliance item in this docket by June 30,
 5 2010.

6 69. The Company did not object to filing Staff's recommended water loss reports.

7 CONCLUSIONS OF LAW

8 1. Farmers is a public service corporation pursuant to Article XV of the Arizona
 9 Constitution and A.R.S. §§ 40-250 and 40-251.

10 2. The Commission has jurisdiction over Farmers and the subject matter of the
 11 application.

12 3. Notice of the proceeding was provided in conformance with law.

13 4. Farmers' FVRB is negative \$748,646.

14 5. The rates, charges and conditions of service approved herein are just and reasonable
 15 and in the public interest.

16 ORDER

17 IT IS THEREFORE ORDERED that Farmers Water Co. Inc. is hereby authorized and
 18 directed to file with the Commission, as a compliance item in this docket, on or before March 26,
 19 2010, a revised tariff setting forth the following rates and charges:

20 MONTHLY USAGE CHARGE:

21 5/8" x 3/4" Meter (All Classes)	\$ 8.25
22 3/4" Meter (All Classes)	9.28
23 1" Meter (All Classes)	10.32
24 1-1/2" Meter (All Classes)	20.64
25 2" Meter (All Classes)	33.02
26 3" Meter (All Classes)	66.04
27 4" Meter (All Classes)	103.19
28 6" Meter (All Classes)	206.38
2" Construction/Standpipe (Assigned)	33.02
6" Construction/Standpipe (Assigned)	206.38

COMMODITY CHARGES

Per 1,000 Gallons

5/8-Inch Meter- Residential

1 to 4,000 Gallons \$1.35

4,001 to 10,000 Gallons 1.90

Over 10,000 Gallons 2.45

5/8-Inch Meter –Commercial and Industrial

1 to 10,000 Gallons 1.90

Over 10,000 Gallons 2.45

3/4-Inch Meter Residential

1 to 4,000 Gallons 1.35

4,001 to 10,000 Gallons 1.90

Over 10,000 Gallons 2.45

1-Inch Meter (All Classes)

1 to 12,500 Gallons 1.90

Over 12,500 Gallons 2.45

2-Inch Meter (All Classes)

1 – 40,000 Gallons 1.90

Over 40,000 Gallons 2.45

3-Inch Meter (All Classes)

1 – 80,000 Gallons 1.90

Over 80,000 Gallons 2.45

4-Inch Meter (All Classes)

1 – 126,000 Gallons 1.90

Over 126,000 Gallons 2.45

6-Inch Meter (All Classes)

1 – 250,000 Gallons 1.90

Over 250,000 Gallons 2.45

2-Inch Construction or Standpipe**(Individually Assigned Customer)**

1 – 40,000 Gallons 1.90

Over 40,000 Gallons 2.45

6-Inch Construction or Standpipe**(Individually Assigned Customer)**

1 – 250,000 Gallons 1.90

Over 250,000 Gallons 2.45

2-Inch Standpipe (No Assigned Customer)

All usage 2.45

6-Inch Standpipe (No Assigned Customer)

All usage 2.45

		Meter	
	<u>Service Line</u>	<u>Installation</u>	<u>Total</u>
1	5/8" x 3/4 " Meter	\$ 135.00	\$ 520.00
2	3/4 " Meter	205.00	620.00
3	1" Meter	265.00	730.00
4	1-1/2" Meter	475.00	995.00
5	2" Turbine Meter	995.00	1,795.00
6	2" Compound Meter	1,840.00	2,640.00
7	3" Turbine Meter	1,620.00	2,635.00
8	3" Compound Meter	2,495.00	3,630.00
9	4" Turbine Meter	2,570.00	4,000.00
10	4" Compound Meter	3,545.00	5,155.00
11	6" Turbine Meter	4,925.00	7,075.00
12	6" Compound Meter	6,820.00	9,090.00
13	8" Meter	At Cost	At Cost
14	10"	At Cost	At Cost
15	12"	At Cost	At Cost

SERVICE CHARGES:

16	Establishment	\$35.00
17	Establishment (After Hours)	50.00
18	Reconnection (Delinquent)	40.00
19	Reconnection (Delinquent – After hours)	55.00
20	Meter Test (If Correct)	25.00
21	Hydrant Meter Deposit (Refundable)	150.00
22	Deposit	*
23	Deposit Interest	6%
24	Re-Establishment (Within 12 months)	**
25	NSF Check	\$20.00
26	Deferred Payment Per Month	1.50%
27	Meter Re-Read (If Correct)	20.00
28	After hours service charge -- Per Rule R14-2-403D	Cost
29	Late Charge per month	1.50%
30	Meter Tampering Charge	Cost
31	Meter Box "Cut Lock" Charge	Cost
32	Meter Box Re-Inspection	***

Company's Proposed

33	*	Per Commission Rules (R14-2-403B)
34	**	Months off systems times the minimum. Per Commission Rule (R14-2-403D)
35	N/T	No Tariff
36		In addition to the collection regular rates, the utility will collect from its customers a proportionate share of any privilege, sales use and franchise tax. Per Commission Rule (14-2-409.D5)

Staff's Recommended

37	*	Per rule R14-2-403.B
38	**	Months of system times the minimum (R14-2-403.D)
39	Late Charge	1.50 percent of the unpaid balance per month

*** Per Rule R14-2-407.B

In addition to the collection regular rates, the utility will collect from its customers a proportionate share of any privilege, sales use and franchise tax. Per Commission Rule (14-2-409.D5)

IT IS FURTHER ORDERED that the rates and charges approved herein shall be effective for all usage on and after April 1, 2010.

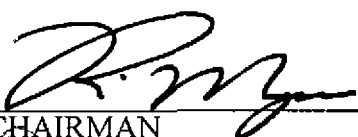

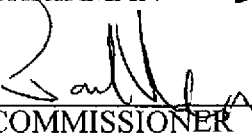
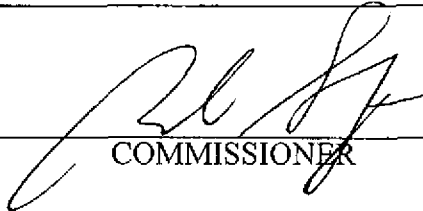
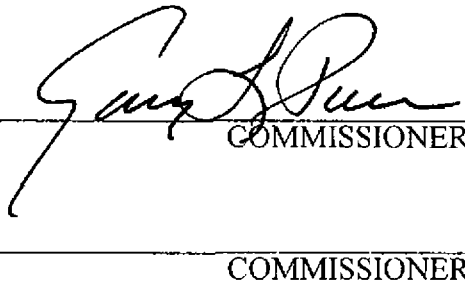
IT IS FURTHER ORDERED that Farmers Water Co. Inc. shall notify its customers of the revised schedules of rates and charges authorized herein by means of an insert in a form acceptable to Staff, included in its next regularly scheduled billing or as a separate mailing to be completed no later than twenty (20) days after the effective date of this Order.

IT IS FURTHER ORDERED that Farmers Water Co. shall develop and file with docket Control, as a compliance item in this Docket, an equity improvement plan by March 31, 2011.

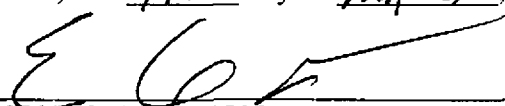
IT IS FURTHER ORDERED that Farmers Water Co. shall file a water loss report with Docket Control as a compliance item in this Docket, by June 30, 2010, such report to indicate the water loss for each system for the year ended December 31, 2009, and if a system's water loss is not less than 10 percent, the report should contain a description of corrective measures demonstrating how the Company will reduce its water loss to less than 10 percent and/or a detailed cost analysis and explanation demonstrating why water loss reduction to less than 10 percent is not cost effective.

IT IS FURTHER ORDERED that this Decision shall become effective immediately.

BY ORDER OF THE ARIZONA CORPORATION COMMISSION.

	
CHAIRMAN	COMMISSIONER
	
COMMISSIONER	COMMISSIONER
	
	COMMISSIONER

IN WITNESS WHEREOF, I, ERNEST G. JOHNSON, Executive Director of the Arizona Corporation Commission, have hereunto set my hand and caused the official seal of the Commission to be affixed at the Capitol, in the City of Phoenix, this 17th day of March, 2010.


ERNEST G. JOHNSON
EXECUTIVE DIRECTOR

DISSENT 

DISSENT _____

1 SERVICE LIST FOR:

FARMERS WATER CO.

2 DOCKET NO.:

W-01654A-08-0502

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